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No. 89-1988

IN THE

Supreme Court Of The United States

OCTOBER TERM, 1990

THE BERKSHIRE GAS COMPANY, *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the District of Columbia Circuit

REPLY BRIEF FOR PETITIONERS

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TABLE OF AUTHORITIES

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This case presents the Court with an essential question concerning the authority of the Federal Energy Regulatory Commission ("FERC" or "Commission") under Sections 4 and 5 of the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717c and d (1982). The court of appeals interpreted the "filed rate doctrine" in an unreasonably rigid manner that deprives the Commission of the only means available for allocating billions of dollars in take-or-pay buydown and buyout costs to the parties most responsible for their incurrence. Thus, rather than honoring the filed rate doctrine, the decision below thwarts the fundamental purpose of the doctrine, *i.e.*, protection of the FERC's primary jurisdiction to set just and reasonable rates.

Petitioners have already demonstrated in the certiorari petition that the filed rate doctrine was not violated by the Commission. To the contrary, it has been faithfully honored.

Respondents, for the most part, raise arguments that go to the merits of the decision by the court of appeals, as opposed to addressing petitioners' claim that the decision below warrants review by this Court. In addition, several of respondents' arguments on the merits go beyond the court of appeals' decision regarding the filed rate doctrine. These arguments focus on the question of whether the Commission's chosen allocation method actually results in just and reasonable rates. While this point was certainly addressed by the Commission, respondents concede that the court of appeals never addressed the arguments concerning the justness and reasonableness of the purchase deficiency allocation method. Columbia Opp. 10, n.17. In fact, one of petitioners' central arguments is that the court below erred when it failed to review the Commission's *substantive* decision approving the purchase deficiency allocation method. In so doing, the court of appeals totally lost sight of the fundamental purpose of the filed rate doctrine.

1. Respondents' principal argument is that the Commission violated the NGA by imposing a rate increase for gas already sold. While respondents couch their arguments in terms of the filed rate doctrine, they in fact advance the rationale underlying the prohibition against retroactive ratemaking. Petitioners have already explained why this Court's decision in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981), does not bar the Commission's adoption of the purchase deficiency allocation method. Pet. 18-21. Likewise, this Court's recent decision in *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 110 S.Ct. 2759 (1990), fails to support respondents' theory of the case. First, the decision on its face is factually distinguishable because it concerned a case wherein a shipper had paid a rate other than the rate on file with and approved by the Interstate Commerce Commission ("ICC"). In this case, all parties are paying Commission-approved filed rates.

Second, assuming *arguendo* that the filed rate doctrine is implicated in this case, the *Maislin* decision clearly states that there is "an important caveat" to the filed rate doctrine - it "is not enforceable if the ICC finds the rate to be unreasonable." 110 S.Ct. at 2767. Here, as petitioners have shown, the Commission has reviewed the various methods for allocating take-or-pay costs presented to it and has concluded that only the purchase deficiency method will result in just

and reasonable rates. Pet. App. 148a-151a. All of the other allocation methods presented in this case have already been reviewed and rejected by the Commission. Consequently, if respondents' theory of the filed rate doctrine is accepted, the Commission will be left with no means of setting just and reasonable rates to permit recovery of pipeline take-or-pay costs.[1]

The caveat noted by this Court in *Maislin* is consistent with the interpretation of the filed rate doctrine urged by petitioners in the certiorari petition. As petitioners argued there, the Court's decision in *Hall* makes clear that the filed rate doctrine is a procedural safeguard intended to preserve the Commission's primary jurisdiction to set just and reasonable rates and prevent undue discrimination. Pet. 19. Here, the Commission has exercised its primary jurisdiction and has set just and reasonable rates. While respondents may disagree with (and seek review of) the Commission's substantive determination that the purchase deficiency method results in just and reasonable rates, their claim that the procedural requirements of the filed rate doctrine have been violated is not well-taken.

2. Respondents further claim that the "central purpose" of the filed rate doctrine is "to render rates definite and certain," Columbia Opp. 17, and that the doctrine is not limited to making the agency aware of rate increases. Process Gas Opp. 5. Petitioners do not deny that rate certainty or predictability is a goal of the filed rate doctrine. It is not, however, the "central purpose" of the doctrine. The central purpose is, as stated by petitioners in the certiorari petition, to allow the Commission to carry out the substantive provisions of the NGA. Similarly, petitioners agree that the requirement in Section 4 of the NGA that rate changes be filed with the Commission serves to give notice to both the agency and the public.

The statute does not, however, provide respondents with a guarantee that pipeline rates will not be changed. The only assurance respondents have when dealing with a FERC-regulated entity is that

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[1] Petitioners recognize that unlike the FERC, the ICC has the statutory authority to order reparations. Petitioners submit, however, that this statutory difference is not pertinent to the proper interpretation of the filed rate doctrine. The important point is that this Court in both *Hall* and *Maislin* recognized that the establishment of just and reasonable rates and prevention of discrimination are the crux of the statutory mandates of both the NGA and the Interstate Commerce Act ("ICA").

the pipeline must propose any rate changes pursuant to the requirements of Section 4 of the NGA and the Commission must act on such rate filings (or on its own motion) consistent with Sections 4 and 5 of the NGA. Respondents are of course entitled to protest any proposed changes and to participate in any proceedings before the FERC.

Respondents are not, however, content to operate within the NGA's statutory framework and rely on the Commission (with review by the courts) to establish just and reasonable rates. Instead, respondents (and the court of appeals) have turned the notion of rate certainty into a cost avoidance doctrine.[2]

3. In a similar vein, respondents argue that the entire scheme of federal regulation would be disrupted "if the Commission were free to determine, in hindsight, that filed prospective rates in past periods were not high enough and customers . . . should now be surcharged." Columbia Opp. 18. Petitioners agree with this assertion, but that is not what the Commission has done in this case. The scenario presented by respondents would clearly constitute impermissible retroactive ratemaking in violation of this Court's decision in *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962). Like the court of appeals, respondents are confusing the filed rate doctrine and the rule against retroactive ratemaking. The latter is limited to a situation wherein the pipeline attempts to recover costs that should have been recovered in a prior period. A finding of retroactive ratemaking results in the denial of any recovery of the costs at issue, as opposed to a finding that a particular method of allocating otherwise properly recoverable costs is illegal. *See* Pet. 24.

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[2] Respondents Process Gas, *et al.* explicitly complain (Process Gas Opp. 8) that they have no means of avoiding these take-or-pay costs by purchasing elsewhere. Respondents completely ignore the fact that while they were purchasing less expensive spot market gas and causing Tennessee to incur take-or-pay liability, petitioners had no choice but to purchase Tennessee's more expensive sales gas. If respondents are "let off the hook" now, the very customers who were unable to benefit from the Commission's early efforts to introduce competition into the natural gas industry will be penalized again by being asked to pay a disproportionate share of costs that are most directly attributable to others. *See also* Pet. App. 34a (Wald, J., dissenting from denial of rehearing *en banc*).

4. The balance of respondents' arguments constitute rebuttals of the Commission's substantive finding that the purchase deficiency method produces just and reasonable rates. In this regard, respondents assert that the purchase deficiency method is not supported by the cost incurrence principle, Columbia Opp. 19-20, and that alternative methods of recovery are available. *Id.* at 23-26. Aside from the fact that these points have no bearing on the filed rate doctrine, they are also factually incorrect.

a. First, respondents argue that Tennessee Gas Pipeline Company's ("Tennessee") claim to a surcharge is not based on findings that its customers induced it to enter into long-term contracts or that its customers failed to meet their contractual obligations. Columbia Opp. 19-20.[3] This argument totally misses the critical point, which is that both the Commission and the presiding judge who heard the case found that there is a causal relationship between a customer's decline in purchases and the pipeline's incurrence of take-or-pay costs. Pet. App. 76a and 150a-151a.

b. Respondents' assertion that two-thirds of Tennessee's settlement costs were related to the reformation of contracts to the benefit of current and future customers again ignores the record. Although Tennessee "estimated" that one-third of its costs were incurred to buy out its existing liabilities and two-thirds were incurred to reform contracts, the Commission found that Tennessee's figures were "speculative" and that the breakdown was "arbitrary." Pet. App. 153a-154a. More to the point, the Commission found that all of these costs were incurred by Tennessee "to resolve its contract problems" and that "given the serious consequences to Tennessee's customers, an arbitrary division of these costs cannot be permitted." *Id.*

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[3] It is difficult to understand how respondents' point is relevant to the issue of allocating take-or-pay settlement costs among Tennessee's customers. If true, the facts alleged by respondents would argue for an outright denial of recovery by Tennessee from any of its customers. The Commission obviously found otherwise and agreed that, given Tennessee's absorption of 50% of its settlement costs, a direct bill based on purchase deficiencies was reasonable.

c. Respondents' claim that there are alternative allocation mechanisms available also ignores the record in this case. Initially, respondents claim that the purchase deficiency method "severely punishes" customers whose purchases declined due to conservation or least-cost purchasing strategies.[4] The simple answer to this assertion is that all of the alternatives severely punish customers that played little or no role in Tennessee's incurrence of these costs because their purchases did not decline. Although respondents complain that they will now lose all the savings resulting from their alternative purchases, petitioners are even more disadvantaged because they were unable (during the period in question) to purchase less expensive gas from alternative suppliers.[5] Respondents ignore the fact that the Commission's program to increase competition in the natural gas industry has not been implemented overnight (*i.e.*, equally available to all from the outset) or without the incurrence of significant costs by all segments of the industry.

After expounding upon the failure of the purchase deficiency method to honor the cost incurrence principle, respondents blithely assert that there are three other alternative methods the Commission could use to allocate Tennessee's take-or-pay settlement costs: (1) include the costs in current sales commodity rates; (2) a direct bill based on current contract entitlement; or (3) a volumetric surcharge. Interestingly, respondents fail to explain how any of these methods honors the cost incurrence principle and results in just and reasonable rates.

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[4] While it may be true that some customers' purchases from Tennessee declined due to conservation and least-cost purchasing, such is not the case as to the principal respondent herein, Columbia Gas Transmission Corporation ("Columbia"). As the record in this case shows, Columbia's practice was to purchase more expensive gas from its affiliated producers in order to avoid incurring take-or-pay on its own pipeline system. Exh. 104 (JER-8) at 24, 31-33.

[5] Respondents also claim that they could not timely reflect Tennessee's direct bill in their own rate filings. Columbia Opp. 24. At least as to respondents Columbia and CNG Transmission Corporation ("CNG"), this is not the case. The Commission has clearly permitted those "downstream" pipelines to pass through 100% of the take-or-pay costs they are obligated to pay to Tennessee. *See, e.g.*, *Columbia Gas Transmission Corp.*, 44 FERC (CCH) ¶ 61,003 (1988) and *CNG Transmission Corp.*, 44 FERC (CCH) ¶ 61,244 (1988), *reh'g denied in pertinent part*, 45 FERC (CCH) ¶ 61,223 (1988).

Moreover, respondents ignore the fact that their first and third suggested alternatives were rejected by the presiding judge, Pet. App. 73a, 83a-84a, and not even presented to the Commission in any of the five competing offers of settlement. Pet. App. 97a-102a. As to sales commodity recovery, the presiding judge found that "[i]t is simply not acceptable to continue the practice of assessing take-or-pay costs to the commodity charge where it will impact only those customers who continue to purchase their gas from Tennessee and at greatly increased cost to them." Pet. App. 73a. As to a volumetric surcharge, the presiding judge found that such a charge would prolong and intensify the crisis because it

> can be expected to drive many customers off the system. Further, one of the basic tenets of cost allocation in the past has been that cost responsibility should follow cost causality. While the bulk of costs varies directly with the amount of gas sold, take-or-pay costs increase with a decrease in gas purchases, that is, as customer purchases decrease, take-or-pay costs increase.

Pet. App. 84a.

Respondents' second alternative - recovery through a direct bill based on current contract entitlement - was expressly rejected on the merits by both the presiding judge and the Commission on the ground that the proposal improperly assigns costs to customers not responsible for their incurrence. Pet. App. 150a and 85a.[6]

Furthermore, even if all the alternatives suggested had not already been rejected on the merits, the mere existence of an alternative does not render the Commission's decision invalid. The Commission clearly has the discretion to choose the allocation method which most fairly distributes these costs among Tennessee's customers.

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[6] Columbia's position throughout the litigation of this case was that Tennessee should be required to recover its take-or-pay costs through its current sales commodity rate. *See* Pet. App. 87a. Columbia indicated in its comments with respect to the settlement proposals filed in this case that it could accept a direct bill based on current contract entitlement. *See, e.g.*, "Comments of Columbia Gas Transmission Corporation In Support of Settlement Subject To Modifications" filed on November 3, 1987, in *Tennessee Gas Pipeline Co.*, Docket Nos. RP86-119, TA84-2-9 and TA85-1-9, p. 4.

As both the majority and dissent noted in *Maislin*, the ICA (and by logical extension, the NGA) "altered the common law by lodging in the Commission the power theretofore exercised by courts, of determining the reasonableness of a published rate." 110 S.Ct. at 2767, *quoting, Arizona Grocery Co. v. Atchison, T. & S.F.R. Co.*, 284 U.S. 370, 384-85 (1932). "The filed rate doctrine was regarded in significant part as a means for ensuring that this allocation of responsibility was respected." 110 S.Ct. at 2776 n.12 (Stevens, J., dissenting opinion). Here, the court below has completely ignored the fact that the "Commission, rather than the courts, should have primary responsibility for administration of the statute." *Id.*

5. Finally, contrary to respondents' assertion, this case is indeed quite similar to the situation presented to this Court in *Mobil Oil Exploration & Producing Southeast, Inc. v. FERC*, 885 F.2d 209 (5th Cir. 1989), *cert. granted sub nom., Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Cos.*, 110 S.Ct. 2585 (1990). Like the *Mobil* case, the decision by the court below: (1) will call into question the validity of approximately 300 orders issued by the Commission affecting 22 pipelines;[7] (2) will potentially unravel the settlement of prudence litigation on numerous pipeline systems; (3) will unravel recovery mechanisms put in place through state regulatory proceedings; (4) will lead to significantly increased litigation at the Commission regarding alternate recovery mechanisms; and (5) will result in serious market disruptions if particular pipelines are unable to both recover their take-or-pay costs and remain competitive suppliers.

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[7] Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 54 Fed. Reg. 52,344 (Dec. 21, 1989), III FERC Stats. & Regs. (Regulations Preambles) (CCH) ¶ 30,867, 31,522 n.78 (1989).

For the foregoing reasons and those stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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